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"The Price is Right(?)" - pointed comments about the state of foodservice pricing, and how current market conditions are exposing the weakness of historic practices

"Chasing Down that Dripping Sound" - a reminder that even the best-structured price programs must be backed up with solid price management, and an "audit template" to help you see how well you're doing

"Art or Science?" - acknowledges the impact of non-financial factors in deciding whether and how to use redistribution

Sorry to be a little late with this month's issue; my clients have been keeping me good and busy! The first commentary just scratches the surface of an important, complex, and growing issue - foodservice pricing practices. The second is a bit of a follow-on reminder about the importance of good price management practices to ensure you're earning what you think you are. And we close with an invitation to add your two cents to a discussion of the "art and science" of deciding how to use redistribution.

Thanks for reading, and as always, let me know what you think. **Tell Dave**

Dave

"...prices are a fast and effective conveyor of information through a vast society in which fragmented knowledge must be coordinated." - Thomas Sowell

"The Price is Right(?)"

At this moment, I'm working with several clients on projects related to pricing.

One wants to standardize their bracket structure across all of their businesses and sales channels. Another is looking into establishing a price model that is tied directly to commodity costs, for a particular set of customers. And a third is working to better understand their total cost-to-serve for various order sizes, in part to determine whether to change their price bracket structure.

At the same time, the role of pricing throughout the foodservice supply chain is receiving an unprecedented amount of press, both inside our industry and in the popular media. The increased interest in pricing is primarily driven by the upward pressure on raw materials fueled by spiraling grain and energy costs. Of specific interest is how to make sure pricing models capture the risks associated with grain and energy.

One recent article on the CNN Newswire proclaimed "Restaurants Spurn Food Contracts for Spot Market." **(Click Here for Article)**

The gist of the article is that:

-food manufacturers are responding to a run-up in commodity costs by shortening the length of price contracts and/or aggressively raising prices

-restaurant chains are responding by switching away from price contracts and instead are purchasing protein products on the spot market

-while the chains may be saving money in the short term, they are adding uncertainty to their future cost and profit levels

-and because Wall Street hates uncertainty, the stock price of the restaurant chains takes yet another hit

Without a doubt, each side gloms onto "commodity costs" when it suits their needs, and conveniently ignores commodity costs when it makes more sense to sweep them under the rug. But the level, trend, and volatility of costs in today's world is forcing us all to lift the rug and re-examine our pricing and purchasing practices in the light of day.

I kicked this around with Brian Finn of The Shamrock Group, a fellow foodservice industry consultant. Brian has a strong background in negotiating protein prices with foodservice customers, and adds some interesting perspectives.

To wit:

"Pricing to foodservice chains is often filled with little discipline and process. The bottom line is for years many manufacturers have offered fixed pricing, with the pricing not even on a formula or indexed to a commodity. Now with high grain and transportation, manufacturers are looking to index their pricing to these "out of control" costs."

"Chains and distributors seek level (fixed) pricing because operators are not able to easily raise their menu prices. However, this method of pricing (fixed) does not allow for the severe commodity costs swings we are now seeing in grain and energy."

"Many manufacturers do not properly educate and discuss the true cost drivers of their products with chains and distributors."

"Too many price agreements are based more upon competitive pressure and consequently do not adequately allow for price relief when these true cost drivers get out of control."

"If a manufacturer is able to negotiate a price agreement that indexes a cost, he must make sure the index is relevant to the real cost of the product and not some "published" number which is not reflected in his P&L."

"What some chains want to do is situationally switch from one method to another based upon which ever method gives them the lowest price."

"Risk management services can play a critical role in pricing agreements with chains and distributors."

As the pricing hot potato gets tossed around among manufacturers, distributors, and operators, there are a few truths which we ALL should bear in mind:

1. Each percent change in price has a greater impact on your bottom line than a percent change in costs, inventory levels, or any other lever.

2. In times of cost and price pressure, "pile on the service - it's free - to maximize repeat business."
(That one's from Jim Sullivan of **Sullivision**).

3. We've been here before, and it's not permanent. As the old sea captain said, "when the sea is calm, I know it's going to get rough. And when the sea is rough, I know it's going to get calm."

So here's wishing you smooth sailing - if not today, then soon!

"Chasing Down that Dripping Sound"

So let's say you've got your act together on pricing, and have been taking regular price increases in order to stay ahead of rising costs. Let's say your Sales Managers and Broker Agencies are excellent at selling in price increases. And let's say your customers grudgingly accept that your company is a price leader, and have learned that it's a waste of time to protest, threaten, stall, or otherwise try to fend off your price action. That's all great.

But what really happens in the weeks and months after your new prices take effect? Are the new prices really appearing on customer PO's? How about on your invoices? And how many customers are actually paying the new prices?

As much as Finance Managers love price increases, they worry about how well they will "stick." And with good reason, because it would be a minor miracle if a "4% across the board" price increase truly resulted in a 4% revenue increase, at least among the foodservice companies I know.

What's more likely to happen is that customer-by-customer, product-by-product, and transaction-by-transaction, your price increase will be whittled away. It's a bit like leaky plumbing, or what the consultants at McKinsey call the "pocket price waterfall." And like leaky plumbing, it can go undetected as long as you're getting water at the tap.

More accurately, it often is suspected (if not detected) but goes on because finding and fixing the leaks is hard, messy work.

That's why we created the "Price Management Audit Template." It's a two-page guide to help you ensure that you're managing prices effectively, both before and after making your price increase announcement. Page 2 focuses on the Ordering, Billing, and Collecting functions.

Do-It-Yourself types can borrow the template from my toolbox at **Dave's Toolbox.**

But if you're too busy to go hunting for the source of "that dripping sound," have a look at the template and give me a call. It may well be worthwhile to turn me loose with a flashlight and pipe wrench to find and fix those leaks before they cause real damage!

"Art or Science?"

Next month I'll be speaking to a group of Jan-San channel distributors about how to optimize the use of redistributors. At the ISSA Interclean convention in Las Vegas, supply chain costs are sure to be as hot a topic as they are in foodservice. And like their foodservice counterparts, jan-san manufacturers and distributors are working to figure out how best to use wholesaler redistribution to optimize supply chain costs and customer service.

While I have no hard data to back it up, my experience is that the jan-san channel has a much higher preponderance of small orders being shipped from manufacturers to distributors than the foodservice channel. I think it's also fair to say that many jan-san manufacturers and distributors have been slower to embrace the concept of wholesale redistribution than their foodservice brethren.

So we've been working with the Sanitary Supply Wholesaling Association **(sswa.com)** to create an Excel-based model that helps distributors calculate the impact of turns, inventory levels, and ROI as well as price when making their sourcing decisions. And at Interclean, we'll show distributors how to gather the pertinent data and use it to help answer the "direct or wholesaler" question.

But we'll also recognize that there is more to this question than just the numbers. A lot of non-financial factors including relationships, attitudes, tradition, and ego go into decisions about whether and how to use wholesaler redistribution. And it's a safe bet that in some cases, these factors even outweigh the financial considerations.

If this rings true to you and you'd like to contribute to the discussion (anonymously of course), just click the "Tell Dave" button below.

Otherwise, thanks again for reading and we'll be back in touch next month.

Comments? Questions? Further Thoughts? Criticism? All are welcome at **Tell Dave**

My Website: **Franklin FS Solutions**